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No. 91-1421

In The

Supreme Court of the United States

October Term, 1991

UNITED STATES OF AMERICA,

Petitioner,

v.

WILLIAM F. HILL AND LOLA E. HILL,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the unrecovered cost of depreciable improvements to an oil and gas mineral deposit may be properly included in the adjusted basis of that property under Section 57(a)(8) of the Internal Revenue Code, for purposes of calculating the amount of depletion which constitutes a tax preference item subject to the minimum tax.

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BRIEF IN OPPOSITION

STATUTES AND REGULATIONS INVOLVED

I. Section 57 of the Internal Revenue Code,[1] 26 U.S.C. 57 provides in relevant part:

> (a) *In General.* – For purposes of this part, the items of tax preference are –
>
> * * *
>
> (8) *Depletion.* – With respect to each property (as defined in Section 614), the excess of the deduction for depletion allowable under

[1] All references to "IRC", "Code", "Internal Revenue Code", or "Section" in this Brief mean Title 26 U.S.C., the Internal Revenue Code of 1954, as amended to the tax years at issue.

> section 611 for the taxable year over the *adjusted basis* of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year). (Emphasis added).

II. Section 1.57-1(h)(3) of the Treasury Regulations[2], 26 C.F.R. 1.57-1(h)(3):

> (3) *Adjusted basis.* For the determination of the adjusted basis of the property at the end of the taxable year see *section 1016 and the regulations thereunder.* (Emphasis added).

III. Section 1.1016-1 of the Treasury Regulations, 26 C.F.R. 1.1016-1 provides in relevant part:

> Section 1016 and Sections 1.1016-2 to 1016-10 inclusive, contain the rules relating to the adjustments to be made to basis of the property to determine the adjusted basis as defined in Section 1011.

IV. Section 1.1016-2(a) of the Treasury Regulations, 26 C.F.R. 1.1016-2(a):

> (a) The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, *including the cost of improvements and betterments made to the property.* No adjustment shall be made in respect of any item which, under any applicable provision of law or regulation, is treated as an item not properly chargeable to capital account but is allowable as a

[2] All references to "Treasury Regulations" or "Treas. Reg." mean Treasury Regulations in effect for the tax years at issue, 26 C.F.R.

> deduction in computing net or taxable income for the taxable year. For example, in the case of oil and gas wells no adjustment may be made in respect of any intangible drilling and development expense allowable as a deduction in computing net or taxable income. See the regulations under section 263(c). (Emphasis added).

STATEMENT

I. During 1981 and 1982, Respondents were engaged in the oil and gas business. The Internal Revenue Code allows the owner of an economic interest in an oil and gas deposit to deduct a reasonable allowance for depletion, when computing taxable income. Code Section 611(a). The depletion deduction is calculated in two ways – based upon cost depletion pursuant to Section 612, and based upon a fixed percentage of the income derived from the property pursuant to Section 613. The higher amount is then claimed as the Section 611 depletion deduction. Treas. Reg. Section 1.611-1(a)(1).

II. The Code also identifies two categories of improvements to an oil and gas deposit: "intangible improvements" and "tangible (depreciable) improvements." Intangible improvements include all expenditures by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas, such as expenditures for clearing ground, draining, road making, surveying, geological work, excavating, grading, and the drilling, shooting, and cleaning

of wells. Treas. Reg. Sections 1.612-4(a) and (b)(1). A taxpayer has the option of either expensing intangible costs (deducting them totally from income in the year they are incurred), or capitalizing them and recovering the cost through the depletion deduction. *See* Treas. Reg. Sections 1.612-4(a) and (b)(1). Tangible improvements include the cost of physical improvements to the oil and gas deposit used in the production of the oil and gas, such as pumps, well equipment, pipes and similar items. *See* Treas. Reg. Sections 1.611-5(b)(4) and 1.612-4(c)(1). Tangible improvements must be recovered through depreciation deductions. *See* Code Section 611(a), Treas. Reg. Section 1.611-5, and Treas. Reg. Section 1.612-4(c)(1).

III. Code Sections 56 and 57 establish a unique separate tax scheme which, through a minimum tax, effectively recaptures certain deductions otherwise allowed under the Code. Each item of tax preference described in Section 57, relates to a specific deduction allowable in a separate section of the Code. (*See* Pet. App. 18a). The tax law *does not*, however, subject all of these tax deductions to the minimum tax. Rather, the minimum tax provisions merely provide a formula for determining how much, *if any*, of the intended regular tax benefit provided by these enumerated tax deductions, will be cut back, or recaptured.[3] Code Section 57(a)(8) provides rules for determining how much of a taxpayer's depletion deductions constitute tax preference items and, therefore, are subject to the minimum tax. Congress specified in Code Section

[3] Code Section 56(a) imposed a 15% minimum tax on the sum of a taxpayer's items of tax preference over certain specified deductions.

57(a)(8), that the depletion claimed during a taxable year with respect to a taxpayer's oil and gas mineral deposit, constitutes a tax preference item and is subject to the minimum tax, only to the extent such depletion exceeds the taxpayer's *adjusted basis* for such property.

IV. Pursuant to Code Section 57(a)(8) and Treas. Reg. Section 1.57-1(h)(3), Respondents calculated their depletion as a tax preference item by including the unrecovered costs of depreciable improvements to their mineral deposits in adjusted basis. The Internal Revenue Service disputed Respondents' calculation and asserted that additional taxes were due. Respondents paid the resulting deficiencies under protest, and filed refund claims, which the IRS denied. Thereafter, Respondents filed suit for refund in the Claims Court.

V. On Cross Motions for Summary Judgment, the Claims Court held that pursuant to Code Section 57(a)(8) Respondents were entitled to include the unrecovered costs of depreciable improvements (*e.g.*, tangibles) in the adjusted basis of their oil and gas mineral deposits. The Court of Appeals affirmed and adopted the opinion of the Claims Court.

VI. There are at least four misstatements of fact or law in the Government's Petition which Respondents desire to bring to the Court's attention:

A. The Petition erroneously states that the Court of Appeals found no "clear indication" in the statute to guide its decision. (*See* Pet. 7). In fact, the decision relies on the plain language of Code Section 57(a)(8) and the related Regulations. The Claims Court and, by adoption, the Court of Appeals, stated as follows:

> "When interpreting Code Section 57(a)(8), absent a clear indication in the Code or Regulations to the contrary, the ordinary Section 1016 meaning of the term adjusted basis should apply." (Pet. App. 11a).

Rather than finding such a contrary indication, the Claims Court found that "Treas. Reg. Section 1.57-1(h) requires that the taxpayer resort to the rules in Section 1016 and related Regulations to calculate the adjusted basis [of property]". (Pet. App. 15a). In this regard, it should be noted that the Petition has failed to discuss or even acknowledge the provisions of the Treasury Department's own Regulations which provided the authority for the Claims Court's decision. *See* Treas. Reg. Section 1.57-1(h)(3), and Treas. Reg. Section 1.1016-2(a). This omission is notable, since Petitioner is required to follow its own Regulations.

B. The decision did not, as the Petition maintains, improperly expand the definition of the term "property" as incorporated in Code Section 57(a)(8) to include depreciable improvements. (Pet. 7, 9, 11, and 13, ftn. 9). This case involves the calculation of the *adjusted basis* of a mineral deposit, not the definition of a mineral deposit. *See* Question Presented.

C. The Petition is incorrect in stating that the legislative history of Section 57(a)(8) supports its position. (Pet. 11). After a detailed review of the legislative history, the Claims Court found that "there are brief statements that arguably benefit each side, but nothing definitive." (Pet. App. 15a, ftn. 10). The Senate Finance Committee Report S. Rep. No. 91-552, 91st Cong. 1st Sess. (1969) cited by the Petition (Pet. 11) was, as the Claims

Court points out, modified by the Conference Committee, H.R. Conf. Rep. No. 91-782, 91st Cong. 1st Sess. (1969) so that the basis of the mineral deposit used to measure the tax preference for depletion is its "adjusted basis" and not its "cost basis."[4] (Pet. App. 15a-17a, ftn. 10). Moreover, the Petitioner has previously admitted, both before the Claims Court and the Court of Appeals, that the legislative history was "not all that helpful." (Pet. App. 15a, ftn. 10). Therefore, the Claims Court correctly concluded, that the critical focus when interpreting Code Section 57(a)(8), must be the *words* of the statute and the related Regulations. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989); *J. H. Miles & Co. v. U.S.*, 3 Cl. Ct. 10, 13 (1983). (Pet. App. 10a). In drafting Code Section 57(a)(8), Congress chose the words "adjusted basis" to measure the amount of depletion that constitutes a tax preference item. Treas. Reg. Section 1.57-1(h)(3) implements this choice by directing that, Section 1016's meaning of the term "adjusted basis" must apply and Treas. Reg. Section 1.1016-2(a)'s requirement that improvements must be included in adjusted basis must be followed.[5]

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[4] The Petition incorrectly states that the "cost basis" of the property is the proper measure of the depletion tax preference item. (*See* Pet. 4, 10, and 11).

[5] Treas. Reg. Section 1.57-1(h)(3) was originally proposed on December 30, 1970 shortly after the enactment of Code Section 57(a)(8). The final regulations made no change in this language. See Federal Register Vol. 35, No. 252 p. 19765. A substantially contemporaneous construction by the Treasury Regulations is presumed to reflect Congressional intent. *See* Justice Blackmun's majority opinion in *National Muffler Dealers Association, Inc. v. United States*, 440 U.S. 472, 477 (1979) and

(Continued on following page)

D. Petitioner's contention that depreciable improvements are not a factor in determining the amount of depletion allowable as a tax deduction is incorrect. (*See* Pet. 10). Code Section 613(a) limits the amount of depletion which can be deducted, for tax purposes, to the gross income from the oil and gas deposit. It is the connection of depreciable improvements to these mineral deposits which allows production and, hence, gross income. In addition, Code Section 613(a) limits the depletion deduction to 50% of the taxable income from the mineral deposit. Taxable income is computed by subtracting various deductions, *including depreciation,* from the property's gross income. Treas. Reg. Section 1.613-5(a). Since Code Section 613(a) makes tangible improvements an integral part of the determination of the depletion allowance, it is only logical that they be included in the calculation of how much depletion will be considered as a

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also the dissent at p. 489 joined by Justice (Now Chief Justice) Rehnquist and Justice Stevens. The 1986 Committee Report cited by Petitioner (Pet. 11) actually supports Respondents because the reference to the *adjusted basis* of the depletable property confirms that the Code Section 1016 meaning of that term should apply. The term depletable property no more defines what basis adjustments are appropriate under Section 1016 than does the term mineral deposit. It is the Treasury Regulations under Code Section 1016, which describe the proper calculation for adjusted basis. While helpful to Respondents, they acknowledge that the views of a 1986 Congress, as to the construction of a statute adopted many hears before by a 1969 Congress, have very little, if any, significance and are not part of the legislative history. *Weinberger v. Rossi,* 456 U.S. 25, 35 (1982); *Andrus v. Shell Oil Co.,* 446 U.S. 657, 665, ftn. 8 (1980); and *Oscar Mayer & Co. v. Evans.* 441 U.S. 750, 758 (1979).

tax preference item under the formula set forth in Code Section 57(a)(8).

REASONS WHY THE PETITION SHOULD BE DENIED

I. THIS CASE DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OF ANY OTHER COURT. FURTHER REVIEW IS NOT WARRANTED.

A. There is No Conflict of Decisions.

There is currently no conflict between this case and any decision of this Court, any other court of appeals, or any lower federal trial court. Petitioner contends, however, that despite this lack of conflict, certiorari should be granted because it is unlikely that other courts of appeals will have an opportunity to review this same issue. (Pet. 9). *This contention is unquestionably erroneous.* There are at least two cases currently docketed in the U.S. Tax Court, *FMC Corporation and Subsidiaries v. Commissioner of Internal Revenue,* Dkt. 2016-90, and *E.I. DuPont deNemours & Company and Affiliated Corporations v. Commissioner of Internal Revenue,* Dkt. 19950-91, which involve the issue of whether depreciable improvements to a mineral deposit may be properly includable in adjusted basis for purposes of Code Section 57(a)(8). Given the sound reasoning behind the decision in this case, if Petitioner persists in its erroneous position, the U.S. Tax Court and other courts of appeal will have the opportunity to consider this issue. There is no reason to assume a conflict will develop. Accordingly, this Court should not depart from its usual practice of waiting to see whether an actual conflict develops.

B. This Case Does Not Present An Important Federal Question.

Petitioner's assertion of the alleged fiscal impact of this decision is unfounded and totally speculative.[6] The total refund claimed by Respondents, in this case, is only $49,426, plus statutory interest. If Petitioner wants a determination of the applicability of this oil and gas case to the hard mineral industry, (see Pet. 12 and 13) the cases currently docketed in the U.S. Tax Court (*see* paragraph A, above), are more appropriate vehicles, because they involve that *exact issue*. It is both inequitable to Respondents and premature to consider that issue by reviewing this case based on pure speculation as to its implications outside the oil and gas industry.

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[6] Petitioner claims that including depreciable improvements in adjusted basis defeats the minimum tax. (Pet. 10). This claim is not true. In the instant case, even though Respondents included depreciable improvements in adjusted basis, they, nonetheless, reported $233,339 and $240,420 of depletion as a tax preference item in 1981 and 1982, and paid a minimum tax. (Pet. 6, ftn. 6)

II. THE COURT OF APPEALS CORRECTLY DECIDED THIS CASE BECAUSE IT APPLIED THE PRECISE FORMULA SET FORTH IN THE CODE AND REGULATIONS FOR CALCULATING DEPLETION AS A TAX PREFERENCE ITEM UNDER CODE SECTION 57(a)(8).

A. Code Section 57(a)(8) and the Related Regulations Provide a Formula for Determining Depletion as a Tax Preference Item.

Contrary to Petitioner's contentions (*see* Pet. 7 and 10), the Court of Appeals' decision applied the *precise formula set forth in the statute and the regulations* for calculating depletion as a tax preference item. Congress specified in Code Section 57(a)(8) that it is only the depletion claimed during the taxable year, with respect to each oil and gas mineral deposit, in excess of the taxpayer's *adjusted basis* for that property, which constitutes a tax preference item. The property, the adjusted basis of which must be determined under Code Section 57(a)(8), is defined in Code Section 614 to mean "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."

The Regulations under Code Section 57(a)(8) specify that the adjusted basis of a mineral deposit, *is determined under Code Section 1016 and the related Regulations. See* Treas. Reg. Section 1.57-1(h)(3). The term "adjusted basis" is precisely defined in the Code and Regulations. The adjusted basis of an oil and gas mineral deposit is its initial cost basis determined under Section 1012, *adjusted as provided in Code Section 1016. See* Code Section 1011(a) and Treas. Reg. Section 1.1011-1. Treas. Reg. Section 1.1016-2(a) provides, in pertinent part, as follows:

> "(a) The cost or other basis shall be properly adjusted for any expenditure . . . or other item, properly chargeable to capital account, *including the cost of improvements or betterments made to the property* . . . ". (Emphasis added).

Since the Code and Regulations specify that the adjusted basis of a mineral deposit, for purposes of Code Section 57(a)(8), *must be increased by the costs of all improvements or betterments made to that property*, the Court of Appeals correctly concluded that depreciable improvements to a mineral deposit must be included in adjusted basis for purposes of Code Section 57(a)(8).

B. The Definition of "Property" Under Code Section 614 Does Not Exclude Depreciable Improvements From the Adjusted Basis of a Mineral Deposit.

The definition of "property", incorporated by Section 57(a)(8) from Section 614, does not require that depreciable improvements to a mineral deposit be excluded from the adjusted basis of that mineral deposit. (*See* Pet. 9). Everyone is in agreement that the property whose *adjusted basis* must be determined, for purposes of Code Section 57(a)(8), is each separate mineral deposit.[7] But the definition of property as the mineral deposit, is only the *starting point* for the calculation of adjusted basis. (*See* Pet. App. 15a and the Question Presented).

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[7] As the Treas. Regulations indicate, the Section 57(a)(8) reference to Section 614 is intended to insure a separate calculation of adjusted basis for each separate mineral deposit. Treas. Reg. Section 1.57-1(h)(1). (Pet. App. 11a).

Section 614 does not provide any rules for determining what adjustments to the cost basis of a mineral deposit are appropriate when calculating adjusted basis. Pursuant to Treas. Reg. Section 1.57-1(h)(3), that subject is covered by Section 1016. In turn, Treas. Reg. Section 1.1016-2(a) provides that the *adjusted basis* of the mineral deposit includes the *cost of improvements or betterments made to the property*. Therefore, any expenditure which constitutes an improvement or betterment to a mineral deposit must be included in adjusted basis under Section 57(a)(8) and the related Regulations.[8]

As the Claims Court found, Petitioner's argument that depreciable improvements are not considered when calculating the adjusted basis of the mineral deposit, is inconsistent with the undisputed way in which Petitioner treats intangible improvements to a mineral deposit. (Pet. App. 15a). Petitioner has admitted that the adjusted basis of a mineral deposit includes intangible improvements, such as road making, clearing ground, excavating, and grading. (*See* Pet. 5, 11, and Pet. App. 6a). However, these intangible improvements are no more mineral deposits than are tangible improvements, such as pumps, well equipment, and pipes. *Both* tangibles and intangibles are

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[8] As the Claims Court noted the issue in this case does not involve the calculation of the amount of the depletion deduction *per se*. The issue here involves the calculation of the amount of the depletion deduction that constitutes an item of tax preference and, hence is subject to the minimum tax. (Pet. App. 9a)

improvements to the mineral deposit because they enhance its value and utility.[9]

This glaring inconsistency in Petitioner's argument is also found in Petitioner's reliance on the definition of mineral enterprise as authority for its position. (Pet. 9). Treas. Reg. Section 1.611-1(d)(3) defines a mineral enterprise as the mineral deposit or deposits and improvements, if any, used in the production of oil and gas. Nothing in the definition of mineral enterprise addresses what constitutes an improvement to a mineral deposit within the meaning of Treas. Reg. Section 1.1016-2(a). Yet, Petitioner asserts that intangible improvements, such as road making, can be added to the basis of the mineral deposit under Code Section 57(a)(8), while tangible improvements, such as pumps and pipes cannot. (*See* Pet. 5, and Pet. App. 6a and 11a). There is nothing in the definition of a mineral enterprise which justifies this distinction. It is merely a "red herring" which attempts to distract this Court's attention from the plain language of Code Section 1016.

C. Code Section 1016 Requires That All Improvements (Both Tangible and Intangible) Must be Added to the Adjusted Basis of a Mineral Deposit.

Petitioner is in effect trying to create a special rule under Code Section 57(a)(8) to exclude tangible improvements when computing adjusted basis for minimum tax -

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[9] "*Improvements*: A valuable addition made to property or an amelioration in its condition, amounting to more than mere repairs . . . intended to enhance its value, beauty or utility or to adapt it for new or further purposes." *See Black's Law Dictionary*, 5th Ed. p. 682.

purposes. There is no authority for such a special rule in either Treas. Reg. Section 1.57-1(h)(3) or Treas. Reg. Section 1.1016-2(a). Petitioner cannot point to any statute or regulation which contradicts the plain language of Treas. Reg. Section 1.1016-2(a), that *all improvements or betterments* to a mineral deposit increase adjusted basis. There is nothing in the language of Treas. Reg. Section 1.1016-2(a) which even remotely distinguishes between the treatment of tangible and intangible improvements to a mineral deposit.[10] *See also*, Treas. Reg. Section 1.1016-2(b), Example. As the Claims Court noted: "Treas. Reg. Section 1.1016-2, which implements Section 1016, in turn provides that costs of improvements

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[10] Both the Courts and the IRS have recognized the interchangeable nature of the unrecovered costs of tangible and intangible improvements to a mineral deposit for tax purposes. In *E.C. Laster v. Commr.*, 43 B.T.A. 159 (1940), *acq.* on other issues, 1941-1 C.B. 7, and 1954-1 C.B. 5, *modified* on another issue, 128 F.2d 4 (5th Cir. 1942), Rev. Rul. 69-332, 1969-1 C.B. 87, and Rev. Rul. 71-207, 1971-1 C.B. 160, taxpayers were required to transmute the unrecovered costs of tangible improvements into unrecovered costs of intangible improvements. Such a result is only permissible if both tangibles and intangibles are included in the adjusted basis of a mineral deposit. In Rev. Rul. 68-361, 1968-2 C.B. 264, the IRS held that rental received from the lease of well equipment was "gross income from the property" under Code Section 613(a). If tangible improvements are not included in the adjusted basis of the mineral deposit, their rental income would not be gross income from the mineral deposit under Code Section 613(a). In TAM 8314011 (Dec. 22, 1982), the IRS ruled that unamortized deferred mine development costs (which under Code Section 616(a) include depreciation deductions) *were includible in adjusted basis for minimum tax purposes, even though they were not subject to depletion.* Technical Advice Memorandums are cited here as being representative of the IRS' administrative position. *See Rowan Companies, Inc. v. U.S.*, 452 U.S. 247 (1981), ftn.17, and *Hanover Bank v. Commr.*, 369 U.S. 672, 686-687 (1962).

and betterments to property that are not deductible (*i.e.*, not expensed) are expenditures properly chargeable to capital account and, hence, should be considered when calculating the 'adjusted basis'." (Pet. App. 7a).[11]

Furthermore, by providing that basis adjustments will be made for expenditures, "*including the cost of improvements or betterments to the property*", Treas. Reg. Section 1.1016-2(a) clearly envisions a basis increase for all improvements or betterments to the mineral deposit without regard to whether they are tangible or intangible. The word "including" is a term of enlargement, not of limitation. *See Tele-Communications, Inc. v. Commr.*, 95 T.C. 495 (1990) and 2A Sutherland's "Statutory Constructions", § 47.07, p.152 (5th Ed. 1992).

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[11] *See* Treas. Reg. Section 1.162-4 and Treas. Reg. Sections 1.263(a)-1(a) and (b). The general rule is that a taxpayer cannot expense "any amounts paid for . . . permanent improvements or betterments made to increase the value of any property." *See also United States of America v. The Albertson Company*, 219 F.2d 920 (9th Cir. 1955) ("Certain expenditures are chargeable to capital account and therefore must be capitalized"); *Ralph E. Purvis v. Commr.*, 65 T.C. 1165, 1168 (1976) (Chargeable to capital account is used in the customary sense of capitalization). Section 1016 is the opposite face of the tax deduction coin . . . "if the deduction is denied because the outlay adds to the value of property or substantially prolongs its life, an increase in basis is, *ipso facto*, warranted." Bittker and Lokken "Federal Taxation of Income, Estates and Gifts", Section 42.1, p. 42-3.

D. Treas. Reg. Sections 1.612-1(a) and 1.612-1(b)(1) Confirm That Tangible Improvements Are Included in the Adjusted Basis of A Mineral Deposit Under Code Section 57(a)(8).

There is one situation, in which taxpayers are directed to deviate from the *general rule* of Code Section 1016 and to distinguish between tangible and intangible improvements for purposes of calculating the adjusted basis of a mineral deposit. This exception creates a *special rule* which specifically excludes "amounts recoverable through depreciation" from adjusted basis, *solely for purposes of calculating cost depletion*. Treas. Reg. Sections 1.612-1(a) and (b)(1) provide, in pertinent part, as follows:

> "Section 1.612-1. *Basis for allowance of cost depletion.*
>
> (a) *In general* – The basis upon which the deduction for cost depletion under section 611 is to be allowed in respect of any mineral or timber property is the adjusted basis provided in section 1011 for the purpose of determining gain upon the sale or other disposition of such property *except as provided in paragraph (b) of this section*. The adjusted basis of such property is the cost or other basis determined under section 1012, relating to the basis of property, *adjusted as provided in section 1016, relating to adjustments to basis, and the regulations under such sections* . . . . (Emphasis added).
>
> (b) *Special rules* – (1) The basis for cost depletion of mineral or timber property does not include:
>
> (i) Amounts recoverable through depreciation deductions, . . . "

The "special rule", provided in Treas. Reg. Sections 1.612-1(a) and (b)(1), for computing the adjusted basis of a mineral deposit for cost depletion, which explicitly excludes tangibles, *must be contrasted* with the language of the Section 57(a)(8) Regulations, which contain no such "special rule" for determining adjusted basis for calculating depletion as a tax preference item. To the contrary, Treas. Reg. Section 1.57-1(h)(3) mandates the ordinary Section 1016 procedure by stating: *"For the determination of the adjusted basis of the property at the end of the year, see Section 1016 and the Regulations thereunder"*. By specifying that for Code Section 612 cost depletion purposes, a "special rule" applies under which tangibles are excluded from the adjusted basis of the property, Treas. Reg. Section 1.612-1 implicitly acknowledges that, absent a special rule, the adjusted basis of the mineral deposit would include depreciable improvements.

This regulation is the "Achilles heel" in Petitioner's argument. It negates all of Petitioner's attempts to create a theoretical justification for its deviation from the plain language and ordinary meaning of the words of Section 57(a)(8), Section 1016, and the related regulations, by references to such concepts as the "definition of property"; or a "mineral deposit versus the mineral enterprise distinction"; or a "separate capital account rule." Treas. Reg. Sections 1.612-1(a) and (b)(1) illustrate that none of Petitioner's concepts address the true issue of how to compute adjusted basis under Section 1016.

III. THE COURT OF APPEAL CORRECTLY DECIDED THIS CASE BECAUSE PETITIONER IS BOUND TO FOLLOW ITS OWN REGULATIONS.

Taxpayers are entitled to rely on the literal language of the regulations. Treasury Regulations are binding on the Petitioner, as they are on the taxpayers.[12] This is the very basis of our self-assessment tax system. Fairness in the tax system requires that taxpayers be able to follow the literal language of the Regulations.[13]

Treas. Reg. Section 1.57-1(h)(3) and Treas. Reg. Section 1.1016-2(a) unequivocally direct taxpayers to include the costs of improvements and betterments in the adjusted basis of a mineral deposit for purposes of Code Section 57(a)(8), without regard to whether they are tangible or intangible improvements. If the result of the literal language of the Petitioner's own Regulations produces, what the Internal Revenue Service perceives to be, an

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[12] *Pacific National Bank of Seattle v. Commr.*, 91 F.2d 103, 105 (9th Cir. 1937). *See, also, Lansons, Inc. v. Commr.*, 622 F.2d 774, 776 (5th Cir. 1980); *Mutual Savings Life Insurance Co. v. U.S.*, 488 F.2d 1142, 1145 (5th Cir. 1974); *Brafman v. U.S.*, 384 F.2d 863, 866 (5th Cir. 1967); and *McCord v. Granger*, 201 F.2d 103, 106 (3rd Cir. 1952).

[13] The articles cited by petitioner (Pet. Ftn. 7) criticize the Court of Appeals' decision as following too closely the precise language in the statute and regulations. The two commentators are conceding that the literal language of the Code and Regulations produces the result reached by the Court of Appeals, but they set forth the surprising *ipse dixit* proposition that the Petitioner can ignore its own regulations, if they produce, what it perceives to be, an undesirable result. This proposition is clearly contrary to established precedent. *See* ftn. 12, *supra*.

unintended or anomalous result, the Petitioner should amend its Regulations. However, when the Petitioner has not taken steps to amend its Regulations,

> "[the] Government's failure to use its broad power in this area does not justify judicial interference in what is, essentially, a legislative and administrative matter."[14]

CONCLUSION

The Claims Court and the Court of Appeals properly rejected the Government's request to retroactively rewrite the Code and Regulations. The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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[14] *Woods Investments Co. v. Commr.*, 85 T.C. 274, 282 (1985); See also *Henry C. Beck Builders, Inc. v. Commr.*, 41 T.C. 616, 628 (1964); *Transco Exploration Co. v. Commr.*, 95 T.C. 373, 384 (1990), *aff'd.* 949 F.2d 837 (5th Cir. 1992); *T. Jack Foster v. Commr.*, 25 T.C.M. 1390, 1417 (1966); *Idaho First National Bank v. Commr.*, 95 T.C. 185, 192,(1990) ftn. 14; and *Honeywell, Inc. v. Commr.*, 87 T.C. 624, 635 (1986).